APPENDIX 12 - U.C.C. ARTICLE NINE: PERFECTION

A. Perfection in Proceeds

Once attached, an Article Nine security interest stays with the collateral when it is sold, exchanged, or otherwise disposed of, unless the secured party expressly or impliedly consents to the "sale or other disposition" free of its interest.[1] When the secured party so consents, the security interest in that collateral is extinguished.[2] Consent is usually present when the debtor's collateral is an asset such as inventory or chattel paper that is regularly sold and replaced as part of the debtor's business activity. Regardless of whether the security interest in the original collateral survives, however, the current language of Article Nine provides that such interest continues "in any identifiable proceeds" of "the sale, exchange, collection, or other disposition . . . ."[3] The requirement in current Article Nine that "proceeds" arise out of a "sale, exchange, or other disposition" is problematic when intellectual property is exploited or enhanced. In order to alleviate these problems, the "disposition" predicate for "proceeds" has been eliminated from Revised Article Nine.

If collateral subject to a perfected security interest (attachment plus a proper filing) generates proceeds under either version of Article Nine, the original perfection automatically carries over into those proceeds for a short period of time. Under current Article Nine, this automatic perfection lasts for ten (10) days.[4] Under Revised Article Nine the period of automatic perfection is twenty (20) days.[5] Perfection in the proceeds will continue beyond the interim automatic period without a new filing covering the proceeds if: (1) the proceeds are identifiable cash proceeds, or (2) the proceeds are collateral in which a security interest "may be perfected by filing in the office or offices where the financing statement has been filed"

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1 U.C.C. § 9-306(2). *See also* U.C.C. [Revised] § 9-315(a)(1)(The Revision language expands the existing reference to "sale, exchange, or other disposition" in present section 9-306(2) to include a "lease" and "license" by the debtor.)

2 *Id*.

3 *Id.*

4 U.C.C. § 9-306(3).

5 U.C.C. [Revised] § 9-315(c)(d)&(e). Curiously, unlike the current rule in section 9-306(3) the Revisions provide no continuous perfection for second generation proceeds, acquired with first generation cash proceeds, even where the original financing statement contains a type indication that covers the second generation proceeds.

that "covers" the original collateral.[6] Under current Article Nine, the income stream from an assignment or other complete and permanent disposition of an underlying intellectual property right would normally be viewed as a general intangible, or in some cases an account.[7] Under Revised Article Nine this income stream would always be an account.[8] As long as an existing filing "covering" the original collateral exists in the appropriate office for perfecting interests in newly generated accounts or general intangibles, perfection in such proceeds should be continuous. Note that the existing filing that "covers" the original collateral need not perfect the original collateral. For example, a financing statement that "covers" federal copyright collateral and is filed within the appropriate state's central file should be effective to continue state law perfection in the income stream "proceeds" even if the proper "state law" place to perfect the original copyright collateral, under the "step-back" filing rule in section 9-302(3)(a), is the Copyright Office.[9] Finally on the issue of priority, Article Nine provides that whenever the order of perfection controls priority between conflicting interests, perfection in the original collateral is also the date of

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6 U.C.C. § 9-306(3)(a). Accord U.C.C. [Revised] § 9-315(c)(1)(B). Under the current language, if second generation proceeds are acquired with "cash proceeds" from the original collateral, perfection can be continuous if the original financing statement indicates "by type" the property constituting the second generation proceeds. *Id.* This continuous protection for second generation proceeds that fall within the collateral types in the financing statement was not carried over into the language of Revised Article Nine.

7 U.C.C. § 9-106. *See* discussionPRELIMINARY REPORT #1: AN OVERVIEW OF THE CURRENT LEGAL RULES AND STRUCTURES GOVERNING THE PERFECTION AND PRIORITY OF SECURITY INTERESTS IN INTELLECTUAL PROPERTY AND AN ANALYSIS OF PROPOSED LEGISLATIVE REFORMS Section II (a)(1)(C) (Cooperative Contract - U.S.P.T.O. and Franklin Pierce Law Center 2000).

8 Income streams from licensing are "accounts" under the definition in Revised Article Nine. U.C.C. [Revised] § 9-102(a)(2). *See* discussion in PRELIMINARY REPORT #1, *supra* note 7 at Section II(a)(1)(D).

9 U.C.C. § 9-302(3)(a),(4) & cmt. 8. If proceeds in the form of receivables generated by the licensing of copyright collateral must also be recorded in the Copyright Office under step-back in section 9-302(3)(a), then this recording of the full security agreement document covering the original collateral under section 205(a) of the Copyright Act should be viewed as the equivalent of filing a financing statement that "covers the original collateral" under section 9-306(3)(a). This equivalence is made clear with respect to the new filing "step-back" rule in section 9-311(a)(1) of Revised Article Nine. U.C.C. [Revised] § 9-311(a)(1). Comment 6 to Revised section 9-315 expressly provides that "compliance with the perfection requirements of a statute or treaty described in Section 9-311(a)" is the equivalent of the filing of a financing statement that covers the original collateral within the meaning of the continuous perfection rule. U.C.C. [Revised] § 9-315, cmt. 6.

continuing perfection as to the proceeds.[10]

1. Disposition Requirement

a) Disposition of Original Collateral

The advantages of carried-over perfection are only available if new property that comes to the debtor through or out of the original collateral is, in fact, "proceeds." "Proceeds" arise, under the language of current section 9-306(1), only from a "sale, exchange, collection, or other disposition" of the collateral.[11] Whenever the debtor sells collateral for money or exchanges it for other property, the required "disposition" is clearly present. Although the extent of disposition required is not clear, there is authority for the position that even a partial disposition of collateral will generate proceeds. In its Commentary No. 9, the Permanent Editorial Board of the Uniform Commercial Code concluded that even when the debtor *leases* goods for a short period of time, a "disposition occurs and the resulting account or chattel paper is "proceeds."[12] The Board's Commentary interprets the word "disposition" in current section 9-306(1) to include even a short term lease of goods, on the theory that the debtor/lessor parts with some portion of the debtor's property.[13] It must be noted, however, that the conclusion of PEB Commentary No. 9 runs counter to a number of earlier cases holding that *only a complete or permanent* disposition was capable of generating proceeds.[14] While Commentary No. 9 rejects this requirement of a complete or permanent disposition, it does not "address other transactions (those involving the licensing of intangibles in particular) where *no* disposition . . . has taken place."[15]

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10 U.C.C. § 9-306(3)(a) & 9-312(6).

11 U.C.C. § 9-306(1).

12 *PEB Commentary No. 9*, [PEB Commentaries] U.C.C. Rep. Serv. 3 (Clark Boardman Callaghan) (June 25, 1992). The commentary relies on the common law rule that the granting of a real estate leasehold interest constitutes a disposition of a *portion* of the lessor's ownership interest in the leased estate. *See, e.g.*, Hueschen v. Stalie, 98 N.M. 696, 652 P.2d 246 (1982); Powell, LAW OF REAL PROPERTY § 221 (1990).

13 *Id.*

14 *In re* Northview Corp., 130 B.R. 543, 548, 15 U.C.C. 1041, 1047-48 (9th Cir. BAP 1991); *In re* S & J Holding Corp., 39 UCC 668, 669 (Bankr. S.D. Fla. 1984); *In re* A.E.I. Corp., 11 B.R. 97,102, 31 UCC 1467, 1469-70 (Bankr. E.D. Pa. 1981); *In re* Cleary Bros. Construction Co., 9 B.R. 40, 30 UCC 1444, 1445 (S.D. Fla. 1980).

15 *PEB Commentary No. 9*, *supra* note 12. The need for even a partial disposition of some

Revised Article Nine addresses this licensing question by moving sharply away from the "disposition" predicate for "proceeds." The 1992 Report of the PEB Study Group on Article Nine suggested that exchange *and replacement* of the original collateral under section 9-306(1) should be viewed as a singular idea.[16] Under a test that looks at a resulting income stream as a *substitution* for value lost in the original collateral, rather than on the *exchange* of all or part of the res, royalties arising from the debtor's nonexclusive licenses should qualify as proceeds.[17] The Report of the Study Group called for a revision of the "proceeds" concept that would either broaden the definition of "disposition" or replace the definition with a concept closer to substitution, in order to include royalties from the debtor's licensing activities."[18]

In response to the charge of the Study Group, section 9-102(a)(64)(A) of Revised Article Nine defines "proceeds" to expressly include "whatever is acquired upon the sale, lease, *license*, exchange, or other disposition of collateral."[19] The language seems to include whatever the debtor acquires in exchange when any type of license of intellectual property is created. That conclusion is not absolutely clear because the concluding phrase of subsection (a)(64)(A), "or other disposition of collateral," might be interpreted as a limitation on the prior enumerated forms, in the sense that all activity listed must be some form of traditional "disposition." If so construed, subsection (a)(64)(A) in the Revised Article Nine definition might still fall under the shadow of the existing rule, making only licenses of intellectual property that disposed of all or some part of the underlying *res* capable of generating proceeds. However, "other disposition" in the Revision need not reflect on the preceding enumerated means for proceeds generation. Including all licenses of intellectual property within the operation of the phrase "acquired upon the . . . license" is certainly more in line with the recommendations of the Study Group.[20] Furthermore, even if the revised language in section 9-102(a)(64)(A) refers only to licenses that

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property "res" has been abandoned in Revised Article Nine. Revised Article Nine defines proceeds to include "(1) whatever is acquired upon the "sale, *lease, license*, exchange, or other disposition of collateral; (2) whatever is *collected on*, or *distributed on account* of collateral; and, (3) rights *arising out of* collateral..." U.C.C. [Revised] § 9-102(a)(64)(A),(B)&(C)(Emphasis added).

16 PEB Study Group on Uniform Commercial Code Article Nine, *Report* 106 & 110 (December 1, 1992).

17 *Id.* at 110.

18 *Id.* at 26, 106 & 110.

19 U.C.C. [Revised] § 9-102(a)(64).

20 *See supra* note 16.

"dispose" of all or part of the underlying property, subsection (a)(64)(B) further defines as proceeds "whatever is collected on collateral."[21] Income received on a license that created no more than a personal right in the licensee would arguably fall within the "collected on" language in Revised section 9-102(a)(64)(B).

While Revised Article Nine expands the definition of proceeds so as to include nearly all contractual exploitations of intellectual property, the disposition predicate in current section 9-306 forces consideration of two serious "proceeds" issues related to intellectual property collateral. First, it is not clear under the current language of section 9-306(1) whether or to what extent a security interest in a specific form of the debtor's intellectual property will carry over as "proceeds" into a new enhanced form that was derived from the original intangible collateral. The broad definition of "proceeds" in the Revisions seems to embrace the notion of evolving collateral rights. Second, as mentioned above, the current disposition predicate seems to limit income stream "proceeds" of intellectual property collateral to those generated by licensing that entails some "disposing" of the debtor's underlying intellectual property *res*. While the Revised "proceeds" definition seems to solve the licensing income problem, current law forces a close examination of the property rules surrounding the debtor's licensing activity.

b) Disposition of a Maturing Right

From the debtor's conception of a single innovation, a trade secret, a patent application, or an issued patent may finally evolve. The authors have examined the argument that a debtor/owner might obtain sufficient section 9-203 "rights" in some mature form of intellectual property, thus allowing a security interest to "attach" to that mature form, from the moment it was conceived of or had existence in some unmatured, unprotected or differently protected form.[22] As was suggested in that earlier discussion, the intellectual property lawyer and the commercial lawyer would be well advised to view each stage of protection as a separate and discrete form of property capable of providing the secured party with attached rights only when each stage is actually reached.[23] Beyond this "inchoate attachment" argument, it is possible to argue that when each separate form of intellectual property right yields to the next form a section 9-306(1) "disposition" of the prior collateral

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21 U.C.C. [Revised] § 9-102(a)(64)(B).

22 *See* discussion in PRELIMINARY REPORT #1, *supra* note 7 at Section II(b)(3)(B).

23 *Id.*

form has occurred.[24] Thus, while a debtor may not actually be able to acquire "rights" in a patent application until the application is filed, that same patent application once filed, could be viewed as the "proceeds" of an earlier trade secret. [Remember that the perfection (including the date of perfection) can carry over from the original collateral into the proceeds.[25]] Similarly, the subsequently issued patent could be viewed as the "proceeds" of its patent application and the second generation proceeds of the earlier trade secret.

This argument that a "disposition" of collateral under current section 9-306(1) embraces the concept of maturing transmutation was rejected by the Bankruptcy Court in the *Matter of Transportation Design and Technology, Inc*.[26] *Transportation Design* held that a patent is not the "proceeds" of a patent application because the issuance of the patent is not a "disposition" of the application within the meaning of section 9-306(1). Despite the circular reasoning, the Court seems to limit "disposed of" to acts of final and permanent disposition analogous to a sale.[27] Under *Transportation Design*, even though a trade secret is lost when a patent issues,[28] it is not "disposed of" in a section 9-306(1) exchange or other disposition.

Transportation Design has been criticized for narrowly interpreting the "disposition" requirement in current section 9-306(1). Defending their comprehensive proposal for a "Federal Article Nine Text" covering federal intellectual property, Professors Weinberg and Woodward argue that secured parties using intellectual property as collateral may need protection against the "risk of surprise metamorphosis."[29] They suggest that *Transportation Design* may not be the best interpretation of the current text of section 9-306(1). If the protection of state trade secret law is "exchanged" for federal patent protection, they argue, then the patent *can* be viewed as section 9-306(1) "proceeds."[30] Weinberg and Woodward ultimately recede from this suggested argument, however, because "trade secrets are quantitatively different from patents."[31] They conclude that under the current Article Nine language the underlying innovation gets new vestments when a patent issues

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[24] See the discussion in Weinberg & Woodward, *Easing Transfers,and Security Interest Transactions in Intellectual Property: An Agenda For Reform*, 79 KY. L.J. 61, 120-121 (1991).

[25] *See* discussion in PRELIMINARY REPORT #1, *supra* note 7 at Section II(c)(1).

[26] 48 B.R. 635, 640, 40 UCC 1393, 1399-1400 (Bankr. S.D. Cal. 1985).

[27] In the case of goods, the Commercial Code defines "sale" as "the passing of title from the seller to the buyer for a price." U.C.C. § 2-106(1).

[28] Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974).

[29] Weinberg & Woodward, *Easing Transfers*, *supra* note 24 at 121.

[30] *Id.* at 117.

[31] *Id.* at 118.

and that these vestments are more than just an exchanged substitute for the old trade secret cloth. While acknowledging this limitation in the current Article Nine text, Weinberg and Woodward remain convinced that a secured party *should* be able to trace a collateral right in a single innovation through its different vestments. To that end, they urged the expansion of the "proceeds" concept as set forth in current section 9-306(1) "to cover new developments."[32]

The definition of "proceeds" in the Revisions moves sharply in the direction favored by Professors Weinberg and Woodward, and well beyond any notions of replacement value. "Disposition" is no longer the centerpiece of the proceeds definition under the Revisions. Revision section 9-102(a)(64) defines "proceeds" to include "whatever is collected on . . . collateral, as well as "rights arising out of collateral." Profits and other enhancing *derivatives* from collateral seem to be included within this definition.

c) Disposition of a License

The language of *Transportation Design* suggested that a license of intellectual property that was not, in substance, an assignment or outright transfer of ownership could not yield "proceeds" because the underlying disposition of the intellectual property by the licensor/debtor would not be final and permanent. While the result suggested by *Transportation Design* may be appropriate under those specific facts, the Court's reasoning overstates the "disposition" requirement because, as already noted, even a *partial* disposition may satisfy current section 9-306(1).[33] Although there is conflict in the case law dealing with tangible property,[34] PEB Commentary

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[32] *Id.* at 118 & 121.

[33] *In re* Northview Corp., 130 B.R. 543, 548, 15 U.C.C. 1041, 1047-48 (9th Cir. BAP 1991); *In re* S & J Holding Corp., 39 UCC 668, 669 (Bankr. S.D. Fla. 1984); *In re* A.E.I. Corp., 11 B.R. 97,102, 31 UCC 1467, 1469-70 (Bankr. E.D. Pa. 1981); *In re* Cleary Bros. Construction Co., 9 B.R. 40, 30 UCC 1444, 1445 (S.D. Fla. 1980). Not all Courts have been rigorous about the section 9-306(1) "disposition" requirement. *In re* Dettman, 84 B.R. 662, 665 (B.A.P. 9th Cir. 1988)(crop diversion certificates were "substitutes" for grapes that were the product of vines that were pre-petition collateral). *But see In re* Northview Corp., 130 B.R. 543, 548, 15 UCC 1041, 1047-48 (B.A.P. 9th Cir. 1991)(rental income not proceeds).

[34] *Compare PEB Commentary No. 9*, *supra* note 12 *with*; *In re* S & J Holding Corp., 42 Bankr. 249, 250 (Bankr. S.D. Fla. 1984)(income generated from use of video machines is not proceeds under section 9-306(1)); *In re* A.E.I. Corp., 11 B.R. 97, 102, 31 UCC 1467, 1469-70 (Bankr. E.D. Pa. 1981); *In re* Cleary Bros. Construction Co., 9 B.R. 40, 30 UCC 1444, 1445 (S.D. Fla. 1980)(security interest in equipment does not include lease proceeds from rental of equipment unless the lease itself is also collateral).

No. 9 on section 9-306(1) concludes that a *partial* disposition of the owner/debtor's underlying property right in goods should be enough of a "disposition" to generate proceeds.[35]

If a license transfers *some part* of the licensor's underlying right, then a license of intellectual property would seem capable of generating proceeds to the same extent as a lease of tangible property. Underlying federal intellectual property law distinguishes a partial transfer of the underlying intangible *res* from a mere personal right to use that *res*. However, this underlying law is not always understood or correctly applied within the appropriate state commercial statute.[36]

Almost infinite divisibility of the underlying *intangible* right is a characteristic of copyright law.[37] A copyrighted work is capable of being divided into segments, each capable of separate ownership.[38] An exclusive license of a copyright is a "transfer of copyright ownership" under the Copyright Act.[39] Therefore, the complete and permanent transfer of such an ownership segment, as distinguished from a personal right to make limited nonexclusive use of the copyright (a nonexclusive license), should generate "proceeds" under the test suggested by the Permanent Editorial Board in its Commentary No. 9.[40] For example, the transfer of *exclusive* movie rights under a copyright can generate "proceeds" because the copyright owner has not just provided the transferee with immunity from suit but has made a complete and permanent disposition of a *part* of the copyright.[41]

In the case of a patent or trademark, however, a license is usually just a contractual promise of immunity from an infringement suit. Even an exclusive patent license does not convey an interest in the patent unless it has the legal effect of an assignment.[42] The exclusive patent license has that legal

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35 *PEB Commentary No. 9*, *supra* note 12.

36 *See, e.g., In re* Quintex Entertainment, Inc., 950 F.2d 1492, 1498 (9th Cir. 1991) This distinction becomes even more critical in bankruptcy.

37 Section 106 of the Copyright Act confers on the holder of a copyright a bundle of separate and distinct exclusive rights. 17 U.S.C. § 106 (1988). The *grant* of one exclusive right does not impair any of the other exclusive rights retained. *See* Columbia Pictures Industries v. Redd Horne, 749 F.2d 154, 158 (3d Cir. 1984).

38 *Compare:* Moore v. Marsh, 74 U.S. 515 (1869) and Merck & Co. v. Smith, 155 F. Supp. 843 (E.D. Pa.), *aff'd* 261 F.2d 162 (3d Cir. 1957) *with* Shutes v. Cheney, 123 Cal App. 2d 256, 266 P.2d 902, 101 U.S.P.Q. 90 (1954). *See also In re* Simplified Information Systems, Inc., 89 B.R. 538, 541 (W.D. Pa. 1988).

39 17 U.S.C. § 101 (1994).

40 *PEB Commentary No. 9*, *supra* note 12.

41 Columbia Pictures Industries v. Redd Horne, 749 F.2d 154, 158 (3d Cir. 1984).

42 Waterman v. Mackenzie, 138 U.S. 252(1891). *See also* 6 WALKER ON PATENTS, § 20:3, (1986).

effect only when it is a grant of the "exclusive right to *make, use, and vend* the invention throughout the United States, or in a specified part thereof, or of any undivided part or share of that exclusive right."[43]

Under current Article Nine language, the income stream from a "license" would seem to be proceeds when the "license" transfers all or some divisible part of the intellectual property.[44] Most exclusive licenses and all nonexclusive licenses are transfers of a much more limited nature, however. The right conveyed to the licensee is more akin to a personal contract right than a disposition of even a part of the underlying *res*.[45] The license protects the licensee from a suit for infringement as long as use does not exceed the contractual authorization.[46] Such a license would not normally carry with it any right that can be separated from the licensor's underlying *res*.[47]

In concluding that a *disposition* of goods by "security lease"[48] or "true lease"[49] creates section 9-306 proceeds, the Permanent Editorial Board in its Commentary No. 9 distinguished the transfer of a partial property interest from the case where only a personal "right to use" was transferred.[50] Under the theory of Commentary No. 9, if there is no disposition of the *goods*, there can be no proceeds. Even though a pure lease of goods results in a section 9-306 disposition, most licenses do not qualify as a section 9-306 disposition because they leave the licensor's *res* undisturbed.

While the concept of transferred ownership might suggest a basis for

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43 5 WALKER ON PATENTS, § 19:12 at 367 (1986).. A nominal exclusive license may have the effect of a grant. *See* Control Components, Inc. V. Atlantic Richfield Co., 439 F. Supp. 654, 655, 200 U.S.P.Q. 334, 334-35 (C.D. Cal. 1977). *See also* Moore v. Marsh, 74 U.S. 515 (1869); Merck & Co. v. Smith, 155 F. Supp. 843 (E.D. Pa.), *aff'd* 261 F.2d 162 (3d Cir. 1957).

44 *See* Merck & Co. v. Smith, 155 F. Supp. 843 (E.D. Pa.), *aff'd* 261 F.2d 162 (3d Cir. 1957).

45 *In re* Alltech Plastics, Inc., 71 B.R. 686, 689 (W.D. Tenn. 1987). *See* Weinberg and Woodward, *Easing Transfers*, *supra* note 24 at 114.

46 Spindelfabrik Suessen-Schurr, Stahlecker & Grill GmbH v. Schubert & Salzer Maschinenfabrik Aktiengesellschaft, 829 F.2d 1075, 1081 (Fed. Cir. 1987).

47 *Id.* at 1081; Public Varieties of Mississippi, Inc. v. Sun Valley Seed Co., Inc., 734 F. Supp. 250 (N.D. Miss. 1990); BGT Enterprises, Inc. v. Gronholz, 406 N.W.2d 321, 323 (Minn. App. 1987); Harris v. Emus, 734 F.2d 1329, 222 U.S.P.Q. 466, 1984 Copyright Dec. 449, 453 (9th Cir. 1984).

48 U.C.C. § 1-201(37) & § 9-102(1)(a).

49 U.C.C. § 2A-102 & § 2A-103(1)(j).

50 PEB Commentary No. 9., supra note 12. See also *In re* S & J Holding Corp., 42 B.R. 249, 39 UCC 668 (Bankr. S.D. Fla. 1984). *But see In re* Dettman, 84 B.R. 662, 665 (9th Cir. B.A.P. 1988)(crop diversion certificates were "substitutes" for grapes that were the product of vines that were pre-petition collateral).

excluding the earnings generated from nonexclusive licenses and many exclusive patent licenses from section 9-306(1), there is an argument for reading "disposition" more expansively when intellectual property is the underlying *res*. The intellectual property which is *disposed of* might be no more than a personal right in the hands of the debtor/transferor. Even when a license is defined as a personal right which is not transferable without the licensor's consent, it seems capable of supporting a security interest in the first instance.[51] If the complete disposition of such an *existing* personal right generates proceeds, creation of the personal right in the first instance ought to be a proceeds-generating act as well.

The new proceeds definition in Revised Article Nine should bring all licensing income under the "proceeds" definition. As the discussion in Section II(c)(2)(A) explains,[52] income, even from a nontransferable nonexclusive license should be "proceeds" under the new language in section 9-102(a)(64).[53] It should apply either under the language of subsection (64)(A) that expressly refers to "whatever is acquired upon the . . . license . . . of collateral"[54] or under the language of subsection (64)(B) that includes "whatever is collected on . . . collateral."[55]

This new "proceeds" definition in the Revisions should also relieve a problem that arises in connection with the mass-market licensing of software and contemporaneous delivery of its embodiment.[56] With software, there is an apparent unity of interest and right. The *tangible* physical property embodies the intangible property. The tangible property is also necessary for the effective use of the intangible property.[57] Software licenses are typified

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[51] *In re* Thomas Communications, Inc., 161 B.R. 621, 624-26 (Bankr. S.D. W.Va. 1993). The question of whether a security interest can be carved out of a governmental license that prohibits assignment without consent is still an open issue. *Compare*: *In re* Ridgely Communications, Inc., 139 B.R. 374 (Bankr. D. Md. 1992) with *In re* Tak Communications, Inc., 138 B.R. 568 (W.D. Wis. 1992), *aff'd* 985 F.2d 916 (7th Cir. 1993). *See also* PEB Study Group on Uniform Commercial Code Article Nine, *Report* 178 (December 1, 1992).

[52] *See* discussion in PRELIMINARY REPORT #1, *supra* note 7 at Section II(c)(2)(A) in text accompanying notes 201 to 206.

[53] U.C.C. [Revised] § 9-102(a)(64).

[54] U.C.C. [Revised] § 9-102(a)(64)(A).

[55] U.C.C. [Revised] § 9-102(a)(64)(B).

[56] *In re* Bedford Computer Corp., 62 B.R. 555, 567 (Bankr. D.N.H. 1986); *In re* C Tek Software, Inc., 117 B.R. 762, 763 (Bankr. D.N.H. 1990). Other cases holding that software products are "goods" include: Step-Saver Data Systems, Inc. v. Wyse Technology, 939 F.2d 91 (3d Cir. 1991); Advent Systems Ltd v. Unisys Corp., 925 F.2d 670 (3d Cir. 1991); RRX Industries, Inc. v. Lab-Con, Inc., 772 F.2d 543 (5th Cir. 1985); Triangle Underwriters, Inc. v. Honeywell, 604 F.2d 737 (2d Cir. 1979).

[57] So-called "commercial licenses" usually involve software imbedded in a disk or other

by a characteristic, which marks intellectual property transactions as *dispositions of property*. The intellectual property license is enhanced by and embodied in physical property, which is generally delivered with the license. With respect to this delivered physical embodiment some "disposition" clearly occurs. According to some authority, such a disposition cannot be prevented, even when the debtor/licensor employs language in the licensing agreement reserving title to the embodiment.[58] If such a reservation is simply to secure a payment or the performance of license terms by the licensee, it should be limited in effect to a security interest.[59] If the licensor is deemed to reserve a security interest only, the title to the embodiment passes to the licensee despite the title reservation language.[60] Even if the circumstance of the license suggests that such language should be given effect as a lease of the underlying embodiment,[61] the resulting leasehold interest that passes to the licensee would be a sufficient "disposition."[62] However, unless the license transferred some part of the underlying

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medium. These licenses may also involve the transfer of access codes and manuals which make the software usable.

58 *See, e.g.*, Microsoft Software License Card, Microsoft Flight Simulator for MS-Dos Version 5.00 para.#4 (1993).

59 U.C.C. § 401(1) & § 1-207(37).

60 *Id.*

61 Whether title to the delivered embodiment can properly be reserved in the licensee requires consideration of the entire transfer agreement and the type of market in which the license is used. A title reservation by a commercial licensor who is paid in installments and fairly expects return of the physical "copy" should be treated like a lease. *See* Draft U.C.C. § 2B-501, Reporter's Note 3 (Discussion Draft, August 1, 1998). On the other hand, the nature of single payment consumer transactions suggest that the licensee has an unlimited right to possess the underlying embodiment or "copy." R. NIMMER, THE LAW OF COMPUTER TECHNOLOGY § 1.18[1] (1992). Most of the cases on the ownership of a "copy" arise under section 117 of the Copyright Act. Only the "owner of a copy of a computer program" has section 117 rights to make a copy or adaptation that would otherwise infringe. 17 U.S.C. § 117 (1994). *See* Applied Information Management, Inc. v. Icart, 976 F. Supp. 149, 154-55 (E.D.N.Y. 1997)(Commercial license with three separate payment periods creates a genuine issue of material fact as to ownership of the delivered copy.); DSC Communications Corp. v. Pulse Communications, Inc., 976 F. Supp. 359, 362-63, rehearing denied, 1997 LEXIS 10093 (E.D. Va. 1997)(Commercial license with single payment makes the transaction a sale of the copy.) Section 2B-501A(a)&(b) of the proposed Uniform Computer Information Transactions Act [formerly proposed Article 2B of the U.C.C.] would allow the location of title to copies to be determined by the "agreement." Draft U.C.I.T.A. § 2B-501A(a)&(b) (Draft, February 1, 1999). "Agreement" is defined broadly in U.C.C. section 1-201(3) to include course of dealing and usage of trade. U.C.C. § 1-201 & § 1-205.

62 *See discussion*in PRELIMINARY REPORT #1, *supra* note 7 at Section II(c)(2)(A).

intellectual property [not the case with a nonexclusive license], there is no section 9-306(1) "*disposition"* of that intangible property sufficient to render the return income to the licensor/debtor "proceeds."[63] Rather than focus on the subtle dual nature of most pre-assembled software packages, some Courts have tended to place the whole transfer transaction in one exclusive category depending, to some extent, on the degree to which the transfer resembles the sale of a "goods" *product*.[64] The "proceeds" issue for the secured party should be whether the underlying intellectual property collateral has been disposed of by the debtor. The Court may treat the total sale and license transaction like a sale of a product or a sale of goods. In this case the secured party which has an interest in the debtor/licensor's "goods" (broadly defined) arguably has a better "proceeds" claim to the income stream from the license than the party with a security interest which is limited to the underlying intellectual property that was retained.

Because software might mistakenly be classified as "goods" under current Article Nine,[65] the commercial software financer should not limit its security interest to the debtor's general intangibles and simply rely on the proceeds right in section 9-306 to hold the resulting income stream. Even a clause covering after-acquired intangibles might not pick up this income stream if the Court decides that the unitary commercial license should be treated as a sale of goods.[66] In that case, the resulting income stream would be classified as an "account,"[67] thus making the intellectual property financer's priority over any existing accounts financer critical.[68]

As noted earlier in Section II(a)(1)(D), Revised Article Nine expands the definition of an "account" to include "a right to payment of a monetary obligation...for property that has been sold, leased, licensed, assigned, or otherwise disposed of . . . ."[69] Because royalties owed to the debtor on

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63 A typical shrinkwrap term in a commercial software license provides that the buyer has not purchased the software itself but has merely obtained a personal nontransferable right to use the program. *See, e.g.*, Arizona Retail Systems, Inc. v. Software Link, Inc., 831 F. Supp. 759 (D. Ariz. 1993).

64 *Id*. *See* Nimmer, *The Uniform Commercial Code Proposed Article 2B Symposium: Article 2B: An Introduction*, 17 J. MARSHALL J. COMPUTER & INFO. L. 211, 213-215 (1997)(software as "goods" cases.).

65 *See* cases cited *supra* at note 56.

66 "Software" is defined as a "general intangible" under the Article Nine Revisions, however. U.C.C. [Revised] § 9-102(a)(42).

67 U.C.C. § 9-106.

68 The first-to-file on either the debtor's goods or the debtor's accounts would have priority in the proceeds generated by the sale of the debtor's goods. U.C.C. § 9-312(5) & Official Comment 8. *See also* U.C.C. [Revised] § 9-317(a)(1) & § 9-322(a).

69 U.C.C. [Revised] § 9-102(a)(2). The present definition of account includes only those

intellectual property collateral are treated as "accounts" under Revised Article Nine, parties lending on the strength of the debtor's intellectual property collateral will have to be wary of account financers even if the licensing of their intellectual property cannot be treated as a disposition of goods. Under the Revisions, anyone financing the debtor's intellectual property will have to file his or her security interest ahead of the debtor's account in order to claim priority in royalties received from the licensing of covered intellectual property.[70]

Finally, the expanded definition in Revised Article Nine also changes the proceeds rules as applied to cross-licensing agreements. Under the current disposition of ownership test, most cross-licensing agreements would not yield "proceeds" under section 9-306 unless the debtor/licensor parts with some transferable *property interest* in the original intellectual property collateral in order to acquire the other party's right to use.[71] The substitution of value test captured in section 9-102(a)(64) of the Revisions will treat all license rights received by the debtor in exchange for rights to use the debtor's own intellectual property collateral as "proceeds" of that collateral.[72]

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rights to payment generated by the sale or lease of goods or the rendering of a service. U.C.C. § 9-106.

70 U.C.C. [Revised] § 9-319(a)(1)&(b)(1).

71 Current section 9-306 does require that the proceeds themselves be a disposition of property by the other party. Proceeds includes "whatever is received." As long as the debtor parts with a transferable *property interest* in the original intellectual property collateral in order to acquire a right to use from the other licensor, the right to use under the license received are "proceeds" of the debtor's original intellectual property collateral. U.C.C. § 9-306(1).

72 U.C.C. [Revised] § 9-102(a)(64). *See also* Superseded Draft U.C.C., Article Nine Revisions - Reporters' Prefatory Comments at 5(f) (Proposed Final Draft, April 15, 1998).